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No. 00-1789

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

PENSION BENEFIT GUARANTY CORPORATION,
Petitioner,

v.

KATHRYN A. BELFANCE, Trustee,
the Copperweld Steel Company Liquidation Trust,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

REPLY BRIEF FOR THE PETITIONER

JAMES J. KEIGHTLEY *
General Counsel
WILLIAM G. BEYER
Deputy General Counsel
ISRAEL GOLDOWITZ
SUSAN E. BIRENBAUM
Assistant General Counsels
KENNETH J. COOPER
NATHANIEL RAYLE
GARTH D. WILSON
Attorneys
PENSION BENEFIT GUARANTY CORPORATION
1200 K Street, N.W.
Washington, D.C. 20005
(202) 326-4020

Of Counsel:
CHARLES G. COLE
STEPTOE & JOHNSON, L.L.P.
1330 Connecticut Ave., N.W.
Washington, D.C. 20036-1795
(202) 429-3000

* Counsel of Record

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I. THE OPPOSITION UNDERSCORES THE NEED FOR THIS COURT TO REVIEW THE COURT OF APPEALS' RULING THAT BANKRUPTCY COURTS MAY IGNORE A REGULATION ADOPTED PURSUANT TO AN EXPRESS CONGRESSIONAL DELEGATION

The brief in opposition illustrates the erroneous reasoning that has led lower courts to ignore an express Congressional direction when determining a pension plan's unfunded benefit liabilities. ERISA defines the unfunded benefit liabilities of a terminated pension plan as the difference between the value of the plan's assets and the value of its benefit liabilities. The statute then specifically directs that the "value of the benefit liabilities under the plan" be determined "on the basis of assumptions prescribed by the corporation [PBGC] . . . ." 29 U.S.C. § 1301(a)(18). Respondent repeatedly argues, however, that a bankruptcy judge is entitled to ignore this explicit direction, and instead determine what Respondent calls the "true economic value" of PBGC's claim. But Congress has already directed how the value of a pension plan's unfunded benefit liabilities is to be measured, and PBGC adopted a regulation to implement Congress's instruction in full compliance with the Administrative Procedure Act. The regulation has never been challenged as arbitrary and capricious in the twenty years since it was originally promulgated.

The brief in opposition does not challenge the validity of the regulation, but rather attacks the institutional competence of PBGC to promulgate regulations that would be effective in bankruptcy. According to Respondent, PBGC "does not claim that it has special expertise that allows it to more accurately reduce future benefits to their present value." Opp. 24. Congress, however, has explicitly recognized PBGC's expertise, and authorized it to prescribe assumptions for measuring unfunded benefit liabilities. Bankruptcy courts

have no power to substitute their judgments for those of the agency to whom Congress has assigned that responsibility. *See Batterton v. Francis*, 432 U.S. 416, 425 (1977).

Respondent's approach, like the decision below, allows bankruptcy courts to usurp both Congress's legislative direction and an agency's implementation of that direction pursuant to an express delegation. It invites bankruptcy courts, based on their own policy assessments, to make *de novo* adjudications of the methodology to be used in determining a pension plan's unfunded benefit liabilities. For example, Respondent asserts that a bankruptcy court should decline to follow the regulatory methodology if it finds that the "purpose" behind the regulation would not be furthered in a bankruptcy context. Opp. 21. The regulation, however, is a uniform rule, and there is no basis in either administrative law or the Bankruptcy Code for a court to evaluate the rule on a case-by-case basis.

Respondent assumes that by applying a "prudent investor rate" derived through hired experts, the bankruptcy court allowed PBGC's claims at their "true value." Respondent also assumes that because the regulatory methodology may serve to encourage the continuation of pension plans, it does not provide an appropriate measure of liability. It is undisputed, however, that the regulatory methodology produces a value that replicates the price of a comparable commodity—the cost of purchasing annuities in the marketplace. Because employers must purchase annuities to complete a standard termination of a pension plan, the regulation assures that the cost of terminating a pension plan is uniform. *See* Pet. 5. And there can be no question that measuring an employer's liability based on the price of annuities in a competitive marketplace is appropriate. "It is an old saying, 'The worth of a thing is the price it will bring.'" *Standard Oil Co. v. Southern Pac. Co.*, 268 U.S. 146, 158 (1925).

In contrast to the objective market value produced under the regulation, the "prudent investor" approach calls for determinations based on result-driven expert testimony. Moreover, the "prudent investor" approach produces a distorted value by plucking the interest assumption from a set of interdependent assumptions prescribed in the regulation and changing it in isolation. Respondent mischaracterizes the regulatory methodology as a "three-step process" by which PBGC calculates a pension plan's unfunded benefit liabilities by first calculating benefits using "assumptions regarding such things as expected retirement ages and life expectancy," and then separately reducing those benefits "to their present value . . . by applying interest factors."[1] Opp. 7-8. In fact, the regulatory methodology replicates the price of annuities only through the *combined* application of the prescribed interest and mortality assumptions.[2] The interest factor is not a free-standing feature that can be replaced with a rate borrowed from some other context.

Despite Congress's express delegation, Respondent contends that a bankruptcy court may rewrite the regulation as it sees fit. Respondent's argument rests on language in section 502(b) of the Bankruptcy Code that directs a bankruptcy court to "determine the amount of [a] claim in lawful currency of the United States." 11 U.S.C. § 502(b); Opp. 26. But nothing in that language suggests that a bankruptcy court

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[1] Respondent repeatedly mischaracterizes PBGC's claim for unfunded benefit liabilities as a stream of future liabilities that must be reduced to present value. It is not. ERISA defines an employer's liability to PBGC as a single amount—"the total amount of the unfunded benefit liabilities (as of the termination date)." 29 U.S.C. § 1362(b)(1)(A).

[2] The interest factor is derived by starting with a survey of annuity prices, and then choosing an "interest rate (or rates) which when *combined* with the PBGC mortality table would accurately replicate the price structure reflected in single-premium, nonparticipating group annuity contract prices from the survey." 58 Fed. Reg. 5128 (1993) (emphasis added).

may set aside the substantive law under which a claim arises.[3] In fact, as this Court held in *Raleigh v. Illinois Dep't of Revenue*, 530 U.S. 15, 20 (2000), "the 'basic federal rule' in bankruptcy is that [nonbankruptcy] law governs the substance of claims." By no stretch is section 502(b) a "qualifying or contrary" provision of the Bankruptcy Code that, under *Raleigh*, empowers a bankruptcy court to override the substantive law. Opp. 26. And Respondent does not even attempt to justify the court of appeals' cramped reading of *Raleigh*, by which it artificially distinguished the amount of a claim from its validity.

Curiously, Respondent relies on cases that did not involve the determination of claims under section 502(b). *United States v. Reorganized CF&I Fabricators*, 518 U.S. 213 (1996), dealt with whether a claim would receive tax priority under section 507 of the Bankruptcy Code, thus entitling it to be paid ahead of general unsecured claims. In other words, the case concerned what *Raleigh* called the "ordering" of claims for distribution purposes. 530 U.S. at 23-24. In *Reorganized CF&I*, the Court concluded that an exaction labeled a tax under the Internal Revenue Code is not necessarily a tax for purposes of the priority provisions of the Bankruptcy Code. 518 U.S. 213. Clearly, priority status is an issue of bankruptcy law, but there is no authority for a bankruptcy court to disregard the substantive law when determining claims under section 502(b). *See Raleigh*, 530 U.S. at 23-24.

The Internal Revenue Service cases cited on page 25 of the brief in opposition involve plan confirmation, an entirely different stage of a bankruptcy proceeding. Specifically, the cases involve section 1129(a)(9)(C) of the Bankruptcy Code,

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[3] A bankruptcy court typically applies the quoted language in a straightforward manner, such as by converting claims denominated in foreign currency into U.S. dollars. *See Finanz AG Zurich v. Banco Economico S.A.*, 192 F.3d 240, 250 (2d Cir. 1999).

which requires that a plan of reorganization provide for deferred payments having a "value," as of the confirmation date, equal to the allowed amount of tax priority claims. These cases do not deal with the determination of claims, but with the valuation of a debtor's delayed payment of tax claims that have already been allowed.

Respondent also cites *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997), to emphasize that the Bankruptcy Code often reshapes debtor and creditor rights. Opp. 24. While this statement may be true on a general level, *Rash* does not support the proposition that a bankruptcy court may set aside the substantive law when determining claims under section 502(b). In *Rash*, there was no dispute over the amount of the creditor's claim as determined under state law. Rather, the case dealt with what portion of that claim would receive secured status under section 506(a) of the Bankruptcy Code. Accordingly, the Court's holding focused on the narrow issue of how collateral is to be valued for purposes of determining what portion of a creditor's allowed claim will be treated as a secured claim.[4]

Finally, like the court below, Respondent relies on section 1123(a)(4) of the Bankruptcy Code, and the policy of equality of distribution. Respondent does not dispute PBGC's point that section 1123(a)(4) governs only distributions on claims that have already been determined. Rather, Respondent repeatedly asserts that the regulatory methodology produces an amount that exceeds the "true value" of PBGC's claim, and contends that if PBGC's claim is determined under the regulation, PBGC would be entitled to a disproportionate

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[4] The decision in *Rash* turned on specific language in section 506(a) of the Bankruptcy Code, which states that an "allowed claim secured by a lien on property . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property" and explicitly directs that "[s]uch value shall be determined in light . . . of the proposed disposition or use of such property." 11 U.S.C. § 506(a).

amount of the remaining distributable estate in this case. Opp. 18, 27. But this does not constitute "special treatment in bankruptcy, different from the treatment afforded other creditors." Opp. 15. When claims are properly determined in accordance with the relevant nonbankruptcy law, and paid on a pro-rata basis, the principle of equality is served despite the fact that the claims differ in size.

Respondent's arguments about equality highlight the faulty reasoning that lower courts have applied when determining PBGC's unfunded benefit liabilities claims. Despite this Court's decision in *Raleigh*, courts continue to impose their own policy views to displace PBGC's regulation and determine PBGC's claim accordingly. PBGC has faced this hostility from bankruptcy courts, and acquiescence by appellate courts, for more than a decade. This Court's intervention is necessary to end this erroneous line of decisions.

II. THE OPPOSITION ILLUSTRATES THE DANGERS OF THE DOUBLE STANDARD CREATED BY THE COURT OF APPEALS' DECISION

In its petition, PBGC pointed out that the decision below creates a double standard by condoning different measures of a pension plan's unfunded benefit liabilities, depending upon whether an employer is in bankruptcy. Respondent does not dispute this. In fact, Respondent endorses this double standard, asserting that the purpose of the regulation is appropriate outside bankruptcy, but not in bankruptcy. Opp. 20. Respondent ignores the need for uniform administration of Title IV of ERISA, preferring to allow bankruptcy courts to make their own regulatory policies. And Respondent also ignores the anomalous results produced by the double standard, like controlled group members being jointly and severally liable for different amounts depending on whether they are in bankruptcy.

Moreover, the brief in opposition underscores the perverse economic incentives that the double standard generates. Respondent points out that other creditors in this case will receive 95% of the remaining net distributable estate, as compared to 6% if the bankruptcy court had determined PBGC's claim under the regulatory methodology. Opp. 27. Such dramatic swings could influence creditors in future cases to pressure a company to terminate underfunded pension plans in bankruptcy.

Respondent attempts to dismiss these concerns, based largely on the assertion that neither the debtors in this case, nor any decision-makers of the debtors, stand to gain anything from the slashing of PBGC's unfunded benefit liabilities claim. Opp. 22. But when companies are in financial distress, management will typically choose a course of action that benefits those who have a continuing relationship with the company, including lenders and suppliers. This is true whether a company is attempting to reorganize or to sell its assets as a going concern. An involuntary governmental creditor like PBGC is therefore an ideal source of "financing" for a reorganization or other restructuring through bankruptcy. Indeed, in the first LTV bankruptcy, it was "undisputed that one of LTV Corp.'s principal goals in filing the Chapter 11 petitions was the restructuring of LTV Steel's pension obligations, a goal which could be accomplished if the Plans were terminated and responsibility for the unfunded liabilities was placed on the PBGC." *PBGC v. LTV Corp.*, 496 U.S. 633, 640 (1990).

The lack of a uniform standard also creates uncertainty and inefficiency, as a bankruptcy court's determination of PBGC's claim in a particular case will depend upon its evaluation of testimony given by actuaries, economists, and other expert witnesses. This is exactly what Congress sought to avoid when it directed PBGC to prescribe uniform assumptions. Respondent dismisses this concern, largely

because the parties entered into a stipulation that eliminated the need for a trial in this case. Opp. 19. But PBGC stipulated in this case solely because it was trying to frame a clean legal issue to expedite a decision and appeal. Before the stipulation was reached, both PBGC and Respondent retained experts and engaged in lengthy discovery. And in the preceding cases involving PBGC's unfunded benefit liabilities claim, both PBGC and the opposing parties used expert witnesses, and the courts conducted trials.

Respondent argues that the potential for litigation in the many bankruptcy cases in which PBGC is involved means that this Court need not grant immediate review. But Respondent does not address the constraints that prevent PBGC from litigating most bankruptcy cases to a final appeal. A battle of experts followed by multiple levels of appeal is an expensive and extraordinarily time-consuming process. At the same time, uncertainty over PBGC's claims can prevent formulation and confirmation of a plan of reorganization, or the distribution of estate proceeds in a liquidation. This leads to intense pressure for PBGC to settle its claims. Indeed, the six years of litigation in this case and the seven-year saga in the *CF&I* bankruptcy demonstrate why bankruptcy constituencies—the debtor, financial and trade creditors, employees, communities—press for a negotiated resolution. And Respondent ignores the fact that debtors, not PBGC, control the circuit in which a bankruptcy petition is filed. As noted in PBGC's petition, several large steel companies with underfunded pension plans and operations in several states have recently filed bankruptcy petitions in Ohio, where the decision below is controlling law. Pet. 24.

Respondent makes much of the $9.7 billion surplus recorded in PBGC's single-employer insurance program during fiscal year 2000, implying that this statistic proves the lack of financial impact of the decision below, and justifies the reduction of PBGC's claim from the amount prescribed

by ERISA. Opp. 17-18. One might as well suggest that the United States government's total surplus of $236 billion in fiscal year 2000 [5] warrants the judicial slicing and dicing of all federal claims. On the contrary, the amount on hand at any given moment is not, by itself, a reliable indicator of whether an insurance fund will be able to pay the claims against it in the future. PBGC's exposure is subject to wide annual swings. Claims are sensitive to changes in interest rates and stock returns, overall economic conditions, the performance of particular industries, and the bankruptcies of a few large companies. As of December 31, 1999, PBGC's estimated "reasonably possible" exposure was $5 billion,[6] and it had ranged as high as $22 billion as recently as September 30, 1996. 2000 PBGC Ann. Rep. 17-18; 1996 PBGC Ann. Rep. 10. Another measure of exposure is the total deficit in underfunded plans insured by the PBGC. In 1997, the most recent year for which data are available, total underfunding in PBGC-insured plans stood at $48 billion, having reached $83 billion only a year before. PBGC, *Pension Insurance Data Book 1999* 40 (tab. S-24) (2000). Consistent with GAO's overall findings in 1998,[7] PBGC concluded in March 2001:

> Large claims from a small number of terminations and volatility characterize the agency's historical experience . . . .
>
> . . . No single underfunding number or range of numbers . . . is sufficient to evaluate PBGC's exposure

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[5] Executive Office of the President, *Budget of the United States Government: Analytical Perspectives, Fiscal Year 2002* 325 (tab. 17-3) (2001).

[6] PBGC classifies the underfunding for plans of financially weak companies (i.e., with below-investment-grade bond ratings) as "reasonably possible" exposure for purposes of its financial statements, consistent with generally accepted accounting principles.

[7] Pet. 23 (quoting GAO, Pension Benefit Guaranty Corporation: Financial Condition Improving, but Long-Term Risks Remain 23 (1998)).

> and expected claims over the next ten years. There is too much uncertainty about the future, both with respect to the performance of the economy and the performance of the companies that sponsor insured pension plans.

2000 PBGC Ann. Rep. 18.

Because most terminations of underfunded pension plans occur in a bankruptcy context, the approach adopted by the court below renders the ERISA regulatory scheme meaningless in the arena where it is most needed. As Respondent's arguments in favor of a double standard illustrate, the bankruptcy community is quite comfortable with creating its own rules and relegating the regulatory scheme to the nonbankruptcy context. Immediate review by this Court is necessary to halt this dangerous trend.

Respectfully submitted,

JAMES J. KEIGHTLEY *
General Counsel
WILLIAM G. BEYER
Deputy General Counsel
ISRAEL GOLDOWITZ
SUSAN E. BIRENBAUM
Assistant General Counsels
KENNETH J. COOPER
NATHANIEL RAYLE
GARTH D. WILSON
Attorneys
PENSION BENEFIT GUARANTY CORPORATION
1200 K Street, N.W.
Washington, D.C. 20005
(202) 326-4020

Of Counsel:
CHARLES G. COLE
STEPTOE & JOHNSON, L.L.P.
1330 Connecticut Ave., N.W.
Washington, D.C. 20036-1795
(202) 429-3000

* Counsel of Record